Internal Revenue Service

memorandum

CC:TL-N-1302-87
Br1:JCAlbro

date: FEB 6 1987

to: District Counsel, Philadelphia
Attn: Kenneth J. Rubin, Asst. District Counsel

from: Director, Tax Litigation Division CC:TL

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subject: [redacted]

This is in response to a request by John A. Georeno, Appeals Officer, for our comments regarding two memoranda submitted by [redacted] with regard to an examination report for taxable year [redacted]. Taxpayer's protest of the examination report was filed [redacted] and a supplement was filed on [redacted]. It is taxpayer's position that the depreciable asset at issue is the customer accounts of registered representatives of [redacted] rather than the the acquired registered representatives themselves. Prior technical advice on the issue in this protest was provided to District Counsel on May 23, 1985. Taxpayer's submissions to the Appeals Officer include a discussion of the technical advice. This case is in the pre-90 stage.

ISSUE

Whether taxpayer may amortize the assigned cost of the customer accounts of the acquired registered agents of a stock brokerage firm. RIRA No. 0167.13-05.

CONCLUSION

Taxpayer may not amortize the assigned cost of the customer accounts of the acquired registered agents because taxpayer purchased the customer structure of a going concern including assets and services of the registered agents; accordingly, as a matter of law, the customer accounts are indistinguishable from the goodwill of the acquired firm.

FACTS

In [redacted], [redacted], through one of its subsidiaries, [redacted] purchased the going concern [redacted], a stock brokerage firm, for approximately $[redacted] For income tax

purposes, the stock purchase was treated as an asset acquisition under section 338 of the Internal Revenue Code. [redacted] assigned a basis of $[redacted] of the acquisition cost to the registered representatives of [redacted] and claimed amortization of the representatives over [redacted] years with a [redacted] tax year deduction of $[redacted]. After the purchase of [redacted] but prior to filing its fiscal [redacted] return, [redacted] hired [redacted] to prepare a valuation analysis of the assets of [redacted]. The valuation analysis purports to establish a basis for claiming amortization of the [redacted] representatives. The taxpayer states that [redacted] determined that one of [redacted]'s intangible assets was the customer accounts of the [redacted] registered representatives, and [redacted] referred to this asset in the valuation study as "registered representatives".

The valuation analysis states that the value of registered agents is their clients because when an agent changes brokerage firms, the majority of the clients follow the agent to the new firm. The analysis states that [redacted] has been successful in retaining about [redacted] to [redacted] percent of a former agent's client base. [redacted] determined the fair market value of the agents by computing the present value of the future adjusted net income to be generated by the agents over their average term of employment. The valuation is based on the price that a prospective buyer would pay for the right to the income associated with the agents in an arm's length agreement, having knowledge of the relative facts and circumstances.

The registered representatives did not have fixed terms of employment pursuant to employment contracts.1/ [redacted] analyzed [redacted]'s personnel records for the period [redacted] through [redacted] in order to determine attrition experience for registered representatives. The [redacted] year useful life was assigned based upon a statistical analysis of the attrition history.

In our May 23, 1985 technical advice (attached) we concluded that a taxpayer may not amortize the cost of acquiring registered agents who were not subject to employment contracts because the services acquired were not susceptible of valuation and were linked to goodwill. Furthermore, taxpayer cannot establish either a limited useful life or that a useful life can be determined with reasonable accuracy.

1/ The sample employment agreements which were provided are terminable by either party upon 30 days notice.

Taxpayer's memoranda of [redacted] and [redacted] emphasize two main points. First, the intangible asset is the customer accounts of the agents and is analogous to a customer list or subscription list, and second, that because of the unique nature of the relationship between registered representatives and customers, when a representative leaves [redacted] his customers go with him. The memoranda also contain point by point discussion of our earlier technical advice. In the discussion which follows we will present Service litigation position with respect to taxpayer's arguments as well as respond to taxpayer's comments on the technical advice, where appropriate.

DISCUSSION

Treasury regulations on the depreciation of intangible assets provide:

> If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance.... An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation.... No deduction for depreciation is allowable with respect to goodwill....

Treas. Reg. § 1.167(a)-3.

The rationale for the depreciation deduction was stated by the Eighth Circuit in Northern Natural Gas Co. v. United States, 470 F.2d 1107, 1109 (8th Cir. 1973), cert. denied, 412 U.S. 939 (1973) as follows:

> This allowance for depreciation is intended to provide a nontaxable fund to restore income-producing assets at the end of their useful life and their capacity to produce income has ceased or, to allow a taxpayer to recoup his investment in wasting assets free of income tax.

Accordingly, an intangible asset can be amortized for depreciation deduction purposes only if the intangible asset is not nondepreciable goodwill. If the asset has attributes of goodwill, it must have (1) an ascertainable value separate and distinct from goodwill and (2) a limited useful life, the duration of which can be ascertained with reasonable accuracy.

Whether these factors are present in a particular case, and whether the intangible asset involved in the case is amortizable must be determined on the facts of the case. The taxpayer has the heavy burden of proving both that an intangible asset has an ascertainable value separate and distinct from goodwill and has a limited useful life. See generally Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240 (5th Cir. 1973); Dobson v. United States, 1 Cl. Ct. 11 (1982).

The most widely used definition of goodwill focuses on the expectancy of the continued patronage of customers. Goodwill is the sum total of those imponderable qualities that attract customers to a business. Boe v. Commissioner, 307 F.2d 339, 343 (9th Cir. 1962). The essence of goodwill is a pre-existing business relationship, based on a continuous course of dealing that may be expected to continue indefinitely and is transferable to the buyer. Computing and Software, Inc. v. Commissioner, 64 T.C. 223, 233 (1975). It is the IRS position that goodwill has been purchased when the acquired business carries with it a valuable customer structure or going concern value. Going concern value has been defined as the ability of a business to continue to function and generate income without interruption as a consequence of a change in ownership. The concepts of goodwill and going concern value do overlap, and for that reason, courts have not always distinguished between the two. Schnee and Cargile, "Going Concern Value-a new intangible?," 15 The Tax Advisor 386 (July 1984). When a taxpayer acquires a customer structure, the intangible asset of the customer accounts is a continually existing asset in which new customers are regularly added and certain old customers are lost. See Boe v. Commissioner, supra. Taxpayer in the instant case, did not purchase only information or some other intangible with a limited period of usefulness in the conduct of the business. Rather, taxpayer succeeded to an existing customer structure, and the self-regenerative customer accounts do not possess a determinable useful life. Such accounts were part of a going concern and were thus indistinguishable from nondepreciable goodwill.

I. Ascertainable Value Separate from Goodwill

A. Legal Analysis

Taxpayer's position is that client loyalty to a particular registered representative is different from the goodwill of [redacted] and that taxpayer has carried the burden to quantify a limited useful life for the services and income stream of the representatives as separate and distinct from goodwill. Taxpayer alleges that the asset at issue is divisible and allocable among the representatives. Because virtually all customer accounts of an agent will remain with the agent if he changes firms, the replacement or renewability feature inherent in the mass asset concept is missing. But See Rev. Rul. 74-456,

1974-2 C.B. 65; Technical Advice, May 23, 1985 (attached). Thus, taxpayer argues, the customer accounts can be categorized by their particular representative, each of whom is separately identifiable and can be accounted for and evaluated on an individual basis.

As will be discussed in detail below, it is our position that [redacted] has not established that the intangible asset has an ascertainable value separate and distinct from goodwill and has a limited useful life, as required by Rev. Rul. 74-456. Taxpayer has also not avoided the application of the mass asset rule. Not only is there not a 100% correlation between representatives leaving and customers leaving (the asset is not divisible and allocable among representatives) but the amortization was not calculated as to value and useful life by either identifiable accounts or representatives.

Various courts have held that customer lists which represent a structure of terminable at will customers do not have limited useful lives and are, therefore, not depreciable. See e.g., Boe v. Commissioner, 307 F.2d 339 (9th Cir. 1962); Thoms v. Commissioner, 50 T.C. 247 (1968); Golden State Towel and Linen Service, Ltd. v. United States, 373 F.2d 938 (Ct. Cl. 1967). The district court in General Television, Inc. v. United States, 449 F.Supp. 609 (D. Minn. 1978), aff'd per curiam, 598 F.2d 1148 (8th Cir. 1979) explained, 449 F. Supp. at 612:

> [W]hat the plaintiff purchased was more than mere subscriber lists which could be used to identify potential customers; what it purchased was customer structures which included the expectancy of continued patronage. Therefore, because the purchases of the subscriber lists were actually purchases of customer structures with the expectancy of continued patronage and because the expectancy of continued patronage is the essence of goodwill, the subscriber lists constitute non-depreciable goodwill.

The essence of [redacted]'s protest is that notwithstanding the [redacted] valuation study which referred to the intangible asset at issue as "[redacted]'s registered representatives," Valuation Study at 6, [redacted] determined that one of [redacted]'s intangible assets was the customer accounts of the [redacted] registered representatives, a depreciable asset in the nature of a customer or subscription list. Protest Memorandum, [redacted] at 2. The Protest Memorandum at 5-6 explains that courts have recognized that the relationship between a business and its customers, represented by a customer list, newspaper subscription list or list of insurance expirations is subject to depreciation by the purchaser. Manhattan Co. of Virginia v. Commissioner, 50 T.C. 78 (1968) (customer list); Houston Chronicle Publishing Co. v. United

States, 481 F.2d 1240 (5th Cir. 1973), cert. denied, 414 U.S. 1129 (1974) (newspaper subscription lists); Richard S. Miller & Sons Inc. v. United States, 537 F.2d 446 (Ct. Cl. 1976)(insurance expirations). The memorandum points out that Rev. Rul. 74-456, 1974-2 C.B. 65, establishes that customer lists and similar assets are depreciable when shown to have an ascertainable value and a limited useful life. Taxpayer argues that the asset at issue here is analogous to the assets in the above-noted decisions. Furthermore, taxpayers states that such lists are merely lists of names, addresses and data relating to the seller's customers. The lists give the buyer the opportunity to form a business relationship with customers and because of the past relationship between the customers and the seller and the expectation that some will establish such a relationship with the buyer, the list has value to the buyer. [redacted] purchased the assets of [redacted], including the intangible asset of the customer accounts of the representatives and states that the value and useful life of the asset was established for purposes of depreciation under section 167 of the Code.

Further analysis of the cases relied on by [redacted] does not support the proposition that the customer accounts at issue may be depreciated in the same manner as the customer lists in the cited cases were held to be depreciable. In Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240 (5th Cir. 1973), the court allowed a depreciation deduction with respect to newspaper subscription lists. The taxpayer in Houston Chronicle acquired subscription lists upon the purchase of a publication which was discontinued. The taxpayer, therefore, did not acquire a customer structure and the expectation of continued patronage by customers through the continued operation of a going concern. The court in Houston Chronicle held that a customer list may be depreciated if it has a value separate and apart from goodwill and if the taxpayer can carry the burden of demonstrating a limited useful life with reasonable accuracy. Although the Service does not dispute this general proposition of law, see Rev. Rul. 74-456, 1974-2 C.B. 65, Service position is that such cases are the exception to the general rule that such lists are not depreciable.

Along with Houston Chronicle, a case which clearly demonstrates the special circumstances which may permit a depreciation deduction for a customer list is Manhattan Company of Virginia, Inc. v. Commissioner, 50 T.C. 78 (1968), acq. 1974-2 C.B. 3. In that case, Manhattan purchased names and addresses of home pickup and delivery laundry customers from a company which was discontinuing this aspect of its business. The Tax Court held that there is nothing inherent in a customer list that makes such an asset nondepreciable per se and noted that it has in many cases disallowed a depreciation deduction in cases involving customer lists. However, the court distinguished those cases on the basis of the fact that the lists of pickup and delivery laundry customers were not purchased as part of a going business. 50 T.C. at 87.

As in Houston Chronicle, the value of the lists to the taxpayers in Manhattan Co. was that they provided taxpayers with a list of logical persons to solicit in an attempt to acquire new customers for their business. Both taxpayers acquired a list of persons to solicit to gain their patronage upon the discontinuance of a competitor's business. Rather than obtaining customers, the taxpayers in Houston Chronicle and Manhattan Co. acquired information which gave them the potential of attracting new customers. See also, Holden Fuel Oil Co. v. Commissioner, T.C.M. 1972-45, aff'd, 479 F.2d 613 (6th Cir. 1973) which involved the purchase of a list of retail fuel oil customers from a company discontinuing home fuel oil deliveries. In Holden, the Tax Court specifically noted that the taxpayer merely acquired the opportunity of contacting persons known to use fuel oil to heat their homes and who were in need of a new supplier. 31 T.C.M. (CCH) at 187.

The only case in which a court has permitted depreciation of a customer list when the acquired business was to be operated as a continuing business is Donrey, Inc. v. United States, No. 86-1377, Slip Op. (8th Cir. Jan. 20, 1987). The Service disagrees with this decision and plans to recommend to the Department of Justice that leave to file a petition for rehearing be requested from the Eighth Circuit panel. Under such circumstances, it has otherwise consistently been held that what has been purchased is the predecessor's entire customer structure, which is simply its goodwill, or an asset so inextricably linked with goodwill that its useful life cannot be determined with reasonable accuracy. See e.g., General Television Inc. v. United States, supra; Meredith Publishing Co. v. Commissioner, 64 F.2d 890 (8th Cir. 1933), cert. denied 240 U.S. 649 (1933); National Weeklies, Inc. v. Commissioner, 137 F.2d 39 (8th Cir. 1943); Westinghouse Broadcasting Co. v. Commissioner, 36 T.C. 912 (1961), aff'd on other issues, 304 F.2d 339 (9th Cir. 1962); Tomlinson v. Commissioner, 58 T.C. 570 (1972), aff'd, 507 F.2d 723 (9th Cir. 1974); Anchor Cleaning Service, Inc. v. Commissioner, 22 T.C. 1029 (1954); Danco Products, Inc. v. Commissioner, T.C.M. 1962-52; Marsh & McLennan, Inc. v. Commissioner, 51 T.C. 56 (1969), aff'd, 420 F.2d 667 (3d Cir. 1969); Skilken v. Commissioner, 420 F.2d 266 (6th Cir. 1969), aff'g 50 T.C. 952 (1968).

Certain customers acquired by [redacted] through its purchase of [redacted] undeniably ceased to be customers at later points in time; however, new customers just as undeniably were acquired over the same points in time, thus keeping a continually existing asset intact. Thus, the loss of a portion of the customer accounts of a registered representative is to be distinguished from cases where taxpayers have been allowed a deduction because they demonstrated the loss of a separate and identifiable segment of their business. See e.g., Metropolitan Laundry Co. v. United States, 100 F.Supp. 803 (N.D. Cal. 1951).

[redacted] purchased an entire customer structure. Unlike the lists involved in Houston Chronicle and Manhattan, it did not matter

which people constituted the customer accounts. [redacted] does not seek to depreciate the information in the customer accounts, which information is of use for only a limited period of time. [redacted] could count on maintaining a stable number of customer accounts through the normal attrition process involving both customers and representatives. Thus, it is clear that the accounts represented the expectation of a continued degree of patronage. The expectation of continued patronage has consistently been held to be the essence of goodwill. See e.g., Winn-Dixie Montgomery Inc. v. United States, 444 F.2d 677 (5th Cir. 1971).

A recent Tax Court decision, Finoli v. Commissioner, 86 T.C. 697 (1986), held that when a partnership acquired a community antenna television system, the subscriber list had no ascertainable value separate and apart from goodwill. The court cited General Television, Inc. v. United States, 449 F.Supp. 609 (D. Minn. 1977), aff'd, 598 F.2d 1148 (8th Cir. 1979) for the proposition that the taxpayer purchased more than the right to service the system's subscribers or a list which could be used to identify actual and potential customers; it purchased customer structures which included the expectancy of continued patronage. "Therefore, because the purchases of the subscriber lists were actually purchases of customer structures with the expectancy of continued patronage and because the expectancy of continued patronage is the essence of goodwill, the subscriber lists constitute non-depreciable goodwill." Finoli, 86 T.C. at 739.

Taxpayer frequently cites and heavily relies on Richard S. Miller & Sons, Inc. v. United States, 537 F.2d 446 (Ct. Cl. 1976). For example, in the [redacted] Memorandum at 5 Miller is cited for the proposition that customer accounts are analogous to the relationship between a business and its customers represented by the insurance expirations which were subject to a depreciation allowance in Miller. It is our position that the Miller case can be distinguished from [redacted] and accordingly, does not support [redacted]'s position for several reasons.

Miller and Sons purchased an insurance agency including its records and papers; the sale did not include tangible personal property or intangibles such as cash, notes, accounts receivable or uncollected premiums. Miller & Sons did not use the agency name, location or or its agents. The court, at 453, discusses the importance of goodwill in a personal service business where the attachment of a client to a particular agent is important and the superiority of service from personal skill and efforts provides a competitive advantage which is difficult to transfer in a sale. Yet, as the successor to the purchased agency, the court recognized that goodwill was an element in the sale, though transfer of an ongoing business was not the primary objective of Miller & Sons.

In contrast, [redacted] acquired an ongoing business including [redacted]'s

registered representatives and yet alleges that no goodwill was obtained in the acquisition. Unlike [redacted] which involves a going concern acquisition, Miller is not a "going concern" case. The court treated the purchased insurance expirations in Miller as a referral list, with an existence separate from the elements of goodwill which were transferred. The purchased expirations were depreciable because they were a mere substitute for the time and effort required to develop and place on the books a comparable number of policies for the first time. Id. at 454. The useful life of this mass asset and its value was tied by the court to the generation of an equivalent quantity of new business by Miller, that is, the cost of adding new policies to the books. Id. at 456. This analysis by the court distinguishes Miller from [redacted] [redacted] argued that it could get customer accounts only by acquiring agents which in the words of the Miller court, is indisputably goodwill. (the attachment of clients to agents in a personal service business). In contrast, the court said Miller & Sons could have acquired the insurance expirations on their own initiative. Therefore, the expirations had an existence separate from other elements of goodwill, such as the attachment of clients to agents.

In summary, what the court approved for depreciation in Miller is not comparable to the customer accounts [redacted] seeks to depreciate but rather is analogous to the depreciable lists in Houston Chronicle and Manhattan (source of new customers). The Miller court approved the depreciation of information which was incorporated into Miller's recordkeeping routines and which was in the nature of a referral list because expirations enable an agent to contact an insured before a contract expires and provides information essential to secure another policy.

The Third Circuit is the Court to which an appeal by [redacted] would lie, and S.S. Ballin Agency, Inc. v. Commissioner, T.C.M. 1969-203, aff'd 446 F.2d 554 (3d Cir. 1971) and Marsh & McLennan, Inc. v. Commissioner, 51 T.C. 56 (1969)aff'd, 420 F.2d 667 (3d Cir. 1969), do not support [redacted]'s position on the depreciation of the customer accounts. The essence of Marsh and McLennan is that when an entire customer structure of a going insurance agency is purchased, the intangible asset (insurance expirations) is so inextricably linked with goodwill that it cannot be separately valued nor can its useful life be determined with reasonable accuracy. The Third Circuit in Ballin, relied on its earlier Marsh and McLennan opinion.

In Marsh and McLennan, taxpayer purchased another insurance brokerage firm and obtained all its assets, liabilities, insurance expirations and employed the selling stockholders and most of the non-stockholding employees. Similarly, S.S. Ballin purchased an insurance agency including the use of the company name, all books and records, insurance expirations and contracts with agents and brokers. These cases are to be distinguished from the Miller case, which did not involve the transfer of the selling agency's brokers or agents, and the insurance expirations were viewed as a referral list.

We believe that in the context of the purchase of a going concern that there is a strong analogy between the insurance expirations and [redacted]'s customer accounts. In Marsh and McLennan, 420 F.2d at 669, the court points out that the insurance brokerage business is highly competitive. Marsh and McLennan had to buy out the other company in order to acquire the particular accounts it wanted to take over. Similarly, [redacted] argues that it is the customer accounts that have value, not the representatives themselves. The transfer of a list of expirations of a going insurance agency business is merely implementing the transfer of goodwill. Id. at 670.

B. Comments on Valuation Methodology

Assuming arguendo that the customer accounts are not goodwill as a matter of law, we disagree with the finding in the valuation study that [redacted] received nothing of value attributable to goodwill. Valuation Study at 11.

There are three basic methods for allocating the purchase price of a business to intangible assets. The contract method follows the allocations specified in the purchase agreement. Under the residual (or gap) method, the value of the intangible assets' including goodwill and going concern value, is computed by subtracting the value of the tangible assets from the purchase price. The tangible assets are valued at the date of purchase, and the purchase price must include all liabilities assumed by the purchaser. The third method for valuing intangible assets is the capitalization of earnings (or formula) method and is set out in Rev. Rul 68-609, 1968-2 C.B. 327. Schnee and Cargile, supra, at 387-89.

[redacted] used the formula method of Rev. Rul. 68-609 and determined no value attributable to goodwill. The method involves capitalizing earnings in excess of a fair rate of return on net tangible assets which is then used to determine fair market value of intangible assets. The ruling provides that the formula method should only be used if no better method for valuing the intangibles is available. It is our position that [redacted] has not met this requirement. Furthermore, it is inconsistent for [redacted] upon using the formula method for valuing intangibles, to reach a result of no value for intangibles (which [redacted] attributed only to goodwill) when [redacted] acquired intangible assets to which value was attributed, namely, the customer accounts and going concern value.

An instructive case is the recent Tax Court decision, Banc One Corp. v. Commissioner, 84 T.C. 476 (1985). Taxpayer purchased two operating banks at prices exceeding book values in the financial records of the banks and allocated a portion of the excess purchase price to depreciable intangible assets of either loan premiums or core deposits. Respondent successfully asserted, Id. at 502, that any excess of the purchase price over the aggregate value of the tangible assets should instead be

allocated to goodwill, going concern value or some other nondepreciable asset under the residual method of valuation. Under the residual method, the value of intangible assets equals the difference between the total purchase price and the value of the tangible assets. Id.

In the instant case, an alleged depreciable intangible asset, the customer accounts, like the intangible assets of goodwill and going concern value, will constitute a portion of the residual after subtracting tangible assets. Taxpayer still has the burden to establish a value for depreciable intangibles separate from goodwill and as discussed infra, it is inherently suspect to have no goodwill value in the acquisition of a going concern.

In Banc One, Coopers and Lybrand also used the formula method of Rev. Rul. 68-609 for valuing intangibles. The court discussed the problems which exist with the formula method and why the residual method is preferable:

> We note initially the difficult and uncertain assumptions demanded by such a computation of intangible value based upon the capitalization of excess earnings. Determination of the normal earnings of a business, the average return on the tangible assets, and the appropriate capitalization rate is a highly subjective task. Indeed, the primary virtue of the residual method is obtaining a more accurate valuation of the acquired intangibles without making speculative assumptions and engaging in unnecessarily complex computations, where the total purchase price and the values of the tangible assets are known or ascertainable.

Id. at 506.

The court then points out that goodwill may arise from something other than excess earnings; excess earnings are merely indicia of goodwill, and it does not necessarily follow that goodwill cannot be present in the absence of excess earnings capacity. A business might possess substantial goodwill or other intangible value and yet be confronted with a substandard tangible asset base or abnormally high operating costs and thus not realize earnings in excess of a normal return on tangible assets. Id. at 507. The court states that the essence of goodwill is the expectancy of continued patronage, for whatever reason while going concern value, also a nondepreciable intangible is the additional element of value which attaches to property by reason of its existence as an integral part of a going concern and is manifested by the ability of the acquired business to continue generating sales without interruption during and after acquisition. Id. at 508.

With the above analysis by the Tax Court in mind, we also note that in Houston Chronicle, even allowing for the fact that the competing newspaper was not purchased to be maintained as a going concern, $775,400 was allocated to goodwill and only

$71,200 was allocated to the subscription list. Here, [redacted] alleges goodwill value is [redacted] and going concern value is less than [redacted] the value of the customers accounts (representatives). Therefore, in Houston even when the special circumstances which permitted a finding that a subscription list was severable from goodwill were found to exist, the value of the list for depreciation purposes was found to be miniscule in comparison to that of the goodwill.

It is our position that [redacted]'s purchase of [redacted] as a going concern precludes assigning a value to the customer accounts as something distinct from the goodwill of the business. The disparity in value between [redacted]'s allocation to the customer accounts separate and apart from goodwill and an allocation of [redacted] to goodwill further demonstrates that [redacted] is attempting to depreciate what is in reality goodwill or nondepreciable going concern value. In summary, we find the allocation of zero value to goodwill to be both factually and legally incorrect. As a matter of law, we believe that the customer accounts do not have a value separate and apart from goodwill. We believe that our analysis of the above-mentioned cases in light of whether a going concern acquisition is involved, establishes this legal proposition.

C. Taxpayer's Comments on Prior Technical Advice

We will comment briefly on some of the points in the [redacted] memoranda. In the [redacted], memo at 22, in opposition to our view that the acquisition of agents' services was an element of goodwill, taxpayer cites Indiana Broadcasting Corp. v. Commissioner, 41 T.C. 793 (1964), rev'd, 350 F.2d 580 (7th Cir. 1965) for the proposition that the acquisition of a service which will attract customers is not goodwill. The quote standing alone does not fairly represent the court's view. The court's position was that the C.B.S. affiliation contracts at issue brought good programs which attracted advertisers (customers). The quote was explaining that the contracts would attract customers, but the asset acquisition (contracts) did not involve a going concern purchase of goodwill. The asset itself must include goodwill; a mere ability to attract customers is not goodwill. The asset acquisition at issue here, existing customer accounts, includes acquired goodwill.

In the [redacted] memo at 23, taxpayer alleges that no authorities have found sports players' services to be elements of goodwill. With personal service contracts, taxpayer must establish an ascertainable value separate and distinct from goodwill and a limited useful life. Such contracts have been held to have measurable value independent of their direct contribution to the value of taxpayer's goodwill. KFOX v. United States, 510 F.2d 1365, 1377 (Ct. Cl. 1975). It is our view that personal service contract cases have not established

that the services are not elements of goodwill but rather that the contracts can be depreciated where they have an ascertainable value separate from the value of goodwill. It is Service position that personal service contracts can be amortized if taxpayer can establish that the contracts can be separately identified as to value and useful life. Furthermore, the important point with regard to Rev. Rul. 67-379, 1967-2 C.B. 27 (baseball player contracts) and Rev. Rul. 71-137, 1971-1 C.B. 104 (football player contracts) is not that reserve or option clauses make stated contract terms irrelevant in determining useful life, [redacted], memo at 10, but that the rulings establish that such individually acquired and individually valued contracts are amortizable. We continue to adhere to the view expressed in our technical advice of May 23, 1985 that the useful life of the terminable at will employment of the [redacted] agents may not be ascertained with reasonable accuracy. In addition, neither the customer accounts nor the agents were individually valued. Such a distinction is also important in Superfood Services, Inc. v. United States, 416 F.2d 1236 (7th Cir. 1969) which taxpayer cites to support the depreciation of terminable-at will contracts. A crucial factor in the Superfood opinion is that the contracts were not treated as a mass but were individually valued at the time of purchase. The [redacted] facts do not bring it within the purview of the Superfood decision.

II. Limited and Ascertainable Useful Life

[redacted] alleges, [redacted] memorandum at 14-17 that they have conclusively demonstrated that the asset at issue has a limited useful life. The two factors on which they rely are customer loyalty to registered representatives and the tendency for customers to follow representatives to a new firm and a term of employment analysis which indicated an [redacted] year average term of employment for registered representatives.

As previously mentioned, [redacted]'s position on the nature of the asset is not altogether clear. In the valuation report at 6 it states that the registered representatives are the asset. Yet, the protest memoranda seek to clarify that the asset is the customer accounts of the representatives. Useful life, though, is based on a statistical analysis which indicates an [redacted] year average term of employment for registered representatives. If the asset is the customer accounts, the appropriate useful life analysis is the life of the accounts, not the employment term of the representatives. The lack of symmetry in the useful life analysis is further demonstrated by the fact that the Client Retention Study, Exhibit B, [redacted] memorandum, establishes that not all customers follow a representative to a new firm. Rather, based on a small sample of [redacted] brokers, between [redacted] and [redacted]% of customers were found to remain with [redacted] after their agent terminated employment. The term of employment of representatives thus has limited meaning for the useful life of customer accounts.

The asset, whether viewed as the accounts or representatives, has perpetual life. Both representatives and customers are lost to the firm but new ones are regularly acquired also. No ascertainable pattern with regard to the useful life of customer accounts has been shown. [redacted]'s statistical studies do not establish the useful life of a wasting asset but rather provide some inconclusive figures regarding a continually existing customer structure.

As a final point, we note that our technical advice of May 23, 1985 was released to the Examination Division and subsequently to the taxpayer. It was attached as Exhibit A to the Engineering and Valuation Report included with the Notice of Proposed Adjustment sent to the taxpayer. Taxpayer was familiar, of course, with the technical advice program pursuant to Rev. Proc. 86-2 and did not understand why they were not provided an opportunity to participate in a conference in the National Office involving this technical advice. The protest memoranda submitted to the Appeal Officer responds to each point in the technical advice.

As a general rule, Tax Litigation Division Technical Advice Memoranda should not be released to the Examination Division. The litigation technical advice program could no longer effectively continue if such documents were publically available, and, of course, the release of any of them compromises our position on nondisclosure. The Tax Litigation Division Manual, (35)8(12)7 even states that taxpayer should not be informed that a technical advice request was made. Unfortunately, in this case taxpayer has had an early opportunity to review an analysis of our litigation position. A Tax Litigation Division technical advice is a confidential advisory opinion protected from discovery under the work-product doctrine and governmental privilege doctrine. Please rectify any misunderstanding about the disclosure of technical advice memoranda.

If you have any questions concerning this matter, please contact Joyce C. Albro, FTS 566-3521.

ROBERT P. RUWE

By: _____
GERALD M. HORAN
Acting Senior Technician
Reviewer, Branch No. 1
Tax Litigation Division

Attachment:
May 23, 1985 Technical Advice